

Recently we wrote yet another article about management decisions made by the leadership of DCAA and how those decisions spawned adverse consequences for the audit agency. We also [wrote recently](#) about at least one call from an industry group to rethink those decisions, to address the unfortunately adversarial relationship between the Pentagon and its suppliers—starting with reducing the “inefficient” and “wastefully expensive” audit practices of the DCAA. That industry call for audit reform noted that “40 percent of DCAA personnel have five or fewer years or less experience in government auditing.” It also noted a “decentralized” audit agency management structure that “allows variation in practice and culture among its auditors” as a contributing cause of the poor audit practices found at DCAA.

Since 2008, DCAA has been under fire from a variety of sources. Each volley has taken aim at poor audit practices that (allegedly) contribute to a host of problems, from lack of timeliness and quality to a lack of usefulness by requesters. The audit agency has taken a number of steps to try to fix its problems (both real and perceived) but the problems persist. A [recent review](#) by the DoD Office of Inspector General found that 81 percent of DCAA audit reports reviewed had one or more significant GAGAS deficiencies.

Fundamentally, both industry and reviewers want to see the same thing in a DCAA audit report. They both want to see conclusions adequately supported by evidence. Unfortunately, that turns out not to be the case in far too many audits.

On December 23, 2014, the DoD OIG issued [another report](#) finding fault with the quality of a DCAA audit report. The DoD OIG found that “the DCAA field audit office did not comply with generally accepted government auditing standards (GAGAS) or agency policy when it questioned \$6.6 million in contractor-claimed subcontract costs.” Moreover, the OIG reported that “The auditor did not obtain sufficient evidence to conclude that the subcontract costs were unsupported ... [and] the field audit office applied an arbitrary and unsupported 20-percent decrement factor to calculate the questioned costs.” In addition, the OIG noted that “the auditor made significant errors on the DCAA Form 1” that was provided to the cognizant Contracting Officer.

In May, 2012, the DCAA FAO No. 3311, located in the Central Region, issued Audit Report No. 3311-2009W10170001, opining on the allowability, allocability, and reasonableness of a contractor’s claimed subcontractor costs in its FY 2008 proposal to establish final billing rates (popularly known as the annual “incurred cost proposal”). According to the OIG—

DCAA concluded that the contractor could not adequately support its claimed subcontract costs of approximately \$33 million ... DCAA based its conclusion on a statistical sample of 70 subcontract invoices, which comprised \$13.5 million of the \$33 million in claimed subcontract costs. DCAA found that the contractor did not provide documentation to support the allowability of any of the 70 invoices.

DCAA found that zero costs in its sample were adequately supported, but decided not to question 100 percent of the \$33 million in claimed costs. Instead, “the FAO elected to question 20 percent (about \$6.6 million) of those costs based on its consideration of contractor performance and product delivery.”

In the foregoing are the makings of a quotidian DCAA audit story, where a contractor performs work and expects to be paid for its incurred costs, yet DCAA finds a way to question those costs and the Contracting Officer is expected to exercise the wisdom of Solomon in negotiating a settlement, which the contractor must then accept or else incur a large amount of attorney fees pursuing justice in court—where there is little guarantee that justice will be found.

We don’t know the contractor or the auditor or the details of the story but, if the story were similar to the ones with which we deal every single day, the most infuriating aspect of the story would be found in the following details reported by the OIG—

Our evaluation disclosed that DCAA failed to comply with Chapter 5 of GAGAS and the AICPA standard by not obtaining adequate evidence to support its conclusion that \$33 million in subcontract costs were unsupported. Specifically, *the auditor’s failure to obtain adequate evidence was due, at least in part, to the auditor not considering all information provided by the contractor.*

For each of the 70 selected transactions, the auditor documented in the working papers her reasons for concluding that the contractor did not adequately support the claimed costs. Then, according to the working papers, the contractor provided a rebuttal to each of the auditor’s conclusions and, in many cases, the rebuttal indicates the contractor provided the auditor with additional information or explanations to support the allowability of the claimed cost. However, we found no evidence suggesting that the auditor appropriately considered the additional information or explanations included in the rebuttal.

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Written by Nick Sanders

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[Emphasis added.]

In our experience, it is not that the contractor objects to a legitimate audit finding; it is that the contractor objects to the DCAA auditor ignoring the evidence provided in order to reach an inequitable conclusion that is actually contradicted by the facts.

That's not to say that there was much (if any) legitimacy to these particular audit findings. For instance, the auditor questioned 12 of the 70 sample invoices because "the contractor could not provide any support for the subcontractor's invoice costs." We take that to mean that the contractor could not show how the subcontractors' costs were supported by the subcontractors' books and records. We don't mean to disparage anybody's professional judgment, but that is a *stupid audit finding*. According to the OIG—

The auditor's notes ... indicated that the auditor would request that the Government audit the invoice costs as the result of [the contractor] not having access to the subcontractor's books and records. The auditor did request an assist audit ... However, the working papers did not indicate if the auditor had appropriately considered the contractor's explanation, or why the auditor questioned the invoiced costs before receiving the assist audit results.

Indeed.

The appropriate course of action is to request assist audits because the contractor does not have access to the subcontractor's financial records and cannot (as a rule) be expected to support the subcontractor's invoiced costs to the same level of detail as the subcontractor can. Yet in this case, the auditor decided to question the subcontractor's costs for lack of support *even though assist audits had been requested* and another DCAA auditor would conclude on the allowability, allocability and reasonableness of those costs. That's not the best professional judgment we've ever seen displayed by a DCAA auditor.

Perhaps in recognition that the audit conclusion that zero percent of the claimed costs had been adequately supported was somewhat questionable (pun intended), the FAO ultimately decided to question only 20 percent of claimed costs, instead of 100 percent. It was a merciful gesture but one that the OIG found to lack merit. The OIG found several reasons that use of

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the 20 percent factor was inappropriate but we liked this one:

... the 20-percent decrement is arbitrary because DCAA lacked a legal, regulatory, or other appropriate basis for establishing the amount of questioned costs it reported and included in the accompanying Form 1. The decrement also failed to provide the contracting officer a rational or otherwise justifiable basis for limiting the potential disallowance to only 20 percent of what DCAA considered to be inadequately supported costs. Thus, the FAO should not have used the decrement to either question the subcontract costs or recommend that the contracting officer disallow them in accordance with FAR. Questioning costs in this manner did not serve a useful purpose to the contracting officer in negotiating a fair and reasonable settlement on the claimed subcontract costs.

Fortunately for the contractor, the Contracting Officer did not sustain the questioned costs. The end result of the audit was favorable, as painful as it must have been for the contractor. All's well that ends well, we suppose.

So how did this quotidian DCAA audit report of a contractor's claimed FY 2008 incurred costs come to the attention of the DoD OIG?

Somebody called the DoD Hotline and complained. Somebody alleged that the DCAA did not comply with professional auditing standards, or DCAA policy, when it questioned the subcontractor costs claimed by the contractor. We don't know who made the complaint.

In the meantime, the auditor has left DCAA. However, there are still thousands of auditors left at DCAA with less than 5 years of experience and with training under questionable management policies. This particular little audit issue was resolved, but other contractors continue to experience similar audit issues every day. One contractor has even [filed suit](#) against DCAA, alleging negligence and professional malpractice.

Audit quality starts with use of professional judgment in evaluating audit evidence. Audit quality continues with issuance of conclusions that are supported by evidence. Audit quality includes reviewing all relevant evidence and, perhaps, audit quality includes revising preliminary conclusions when the audit evidence indicates that the preliminary conclusions were wrong.

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Until DCAA focuses on audit quality as its number one mission and until DCAA measures and tracks audit quality as its number one metric, meaningful reform at the audit agency will never be achieved. And if no meaningful reform is ever achieved, the defense acquisition stakeholders will find other players to perform the role once held exclusively by the Defense Contract Audit Agency.